MID-SIZE RURAL COMPANY PERSPECTIVES ON THE "RURAL RECONCILIATION" REFERRAL TO THE FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE

JUNE 2005

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I. COMPANIES PARTICIPATING.

A. **CenturyTel** serves 2.3 million lines, in 22 states, in exchanges averaging 2,247 lines.
B. **Consolidated Communications** serves 252,000 lines in 59 exchanges in Illinois and Texas.
C. **FairPoint Communications** serves 276,000 lines through 27 companies in 17 states.
D. **Iowa Telecommunications** serves 266,000 lines in 425 rural Iowa communities, is rehabilitating distressed GTE lines, and is the nation's smallest price cap carrier.
E. **TDS** serves 700,000 lines through 112 local companies, in 28 states, averaging fewer than 2000 lines per exchange.
F. **Valor Telecommunications** serves 537,000 lines in 257 mostly rural communities in Texas, New Mexico, and Oklahoma, and is rehabilitating distressed GTE lines.

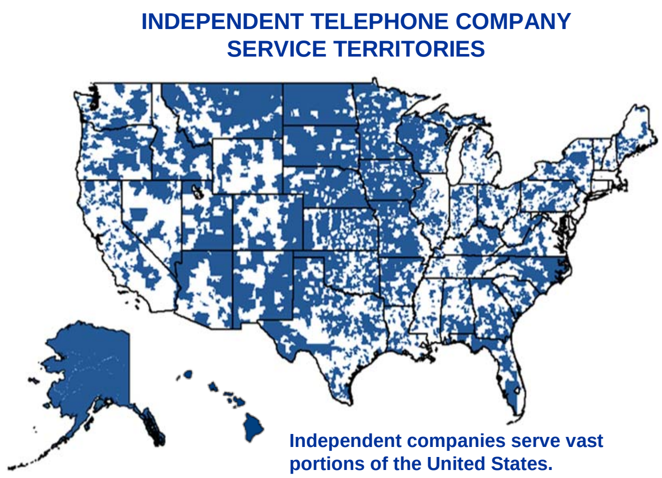
II. SUMMARY OF KEY POINTS.

A. Mid-size carriers provide **excellent service**, including costly Carrier of Last Resort, are aggressively deploying DSL and other **new services**, are **rehabilitating distressed properties** they acquire, and are vital participants in local **economic and community development.**
B. **Investment incentives** for rural markets require rational, predictable Universal Service policies.
C. **Intercarrier compensation** reform is already causing substantial **uncertainty**.
D. Universal Service Fund increases are ***not*** being driven by support to rural holding companies: Their per-line support is ***declining***.
E. The **"rural" definition** should not be modified, and study areas should not be consolidated.
F. **Support** should be based on each company's **own costs**, not another company's costs.
G. Generally, **embedded** cost methodology works well, but rural price cap companies should be given a forward looking option.
H. State and federal **ETC certification** and review are critical to providing discipline and accountability.
I. Policy makers must finally clarify that the High Cost Fund's primary purpose is to **support high-quality networks** over which multiple services can be deployed, not subsidize competition.

J. The **fund cap** and **rural growth factor** must be addressed.
K. Rules for **transferred exchanges** require further modification to support rehabilitation.
L. **Customer needs** must be the top priority!

III. MID-SIZE CARRIERS PROVIDE EXCELLENT SERVICE TO RURAL AMERICA.

A. Very low population density compares to BOCs.
B. Most all exchanges have fewer than 5,000 lines.
C. Mainly residential customers.
D. Like other rural companies, they depend on the "three legged stool" of access, universal service, and rates.
E. Publicly traded companies have strong cost control incentives.
F. Access lines, access revenue, and USF are all declining, even as terminating access and new service demands increase.
G. Acquiring and rehabilitating distressed BOC and other rural properties is an important role.
H. Aggressively deploying broadband in rural communities.
I. Fulfilling the Act's vision of **"reasonable comparability"** of rates and service, and access to advanced services.



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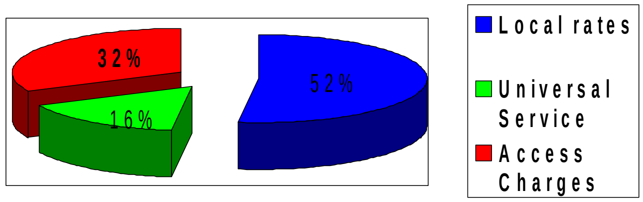
"Three legged telecom stool"



Rural costs are recovered from three sources. Policy has shifted cost recovery from access to universal service, with no revenue increase to rural ILECs.

Source: NECA 2001-2002, data from NECA companies

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IV. UNIVERSAL SERVICE INCREASES ARE NOT DRIVEN BY "NEW" SUPPORT FOR RURAL COMPANIES.

A. RLECs receive little "new money"; rather, network support was transferred from intercarrier access payments to explicit USF support.
   1. Support to most rural mid-size companies is going *down*, not up, and the mismatch between costs and support is increasing.
   2. Due to "identical support," wireless CETCs *did* receive "new money" from the switch from access to USF, as they did not receive intercarrier access payments.

B. CETC support will reach $825.70 in 2005, nearly 20% of Fund, even though the two largest companies (Verizon and Cingular) have generally not applied for support.

C. CETCs receive identical support, but don't have identical regulatory responsibilities, COLR-driven networks, or cost structures.

D. Disciplined FCC and state certification processes are critical to ensure customers receive benefit for support provided.
   1. Consider moratorium on new certifications until state rules and procedures fully implemented.

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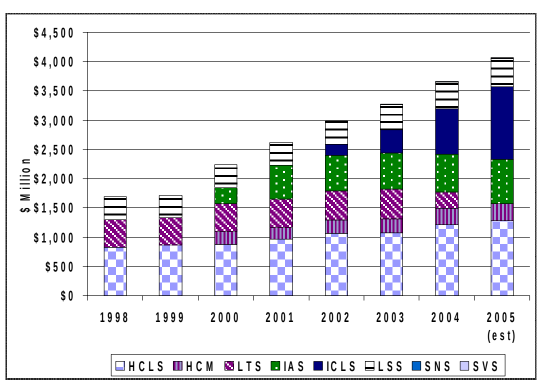
High Cost Funding
by Component ($Million)



HCLS = loop; HCM = Model (large co); LTS = long term; ICLS = interstate common line; LSS = local switching; SNS = safety net; SVS = safety valve

Note: Step function increases from program changes, shift from access revenue to universal service

Source: USAC

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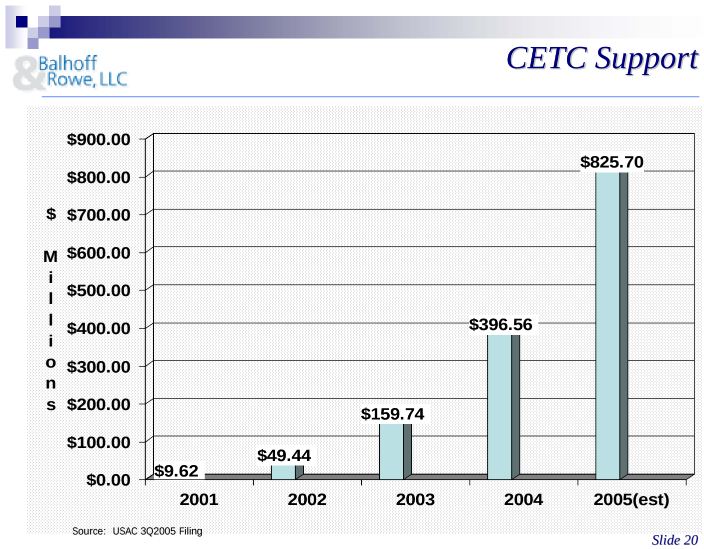
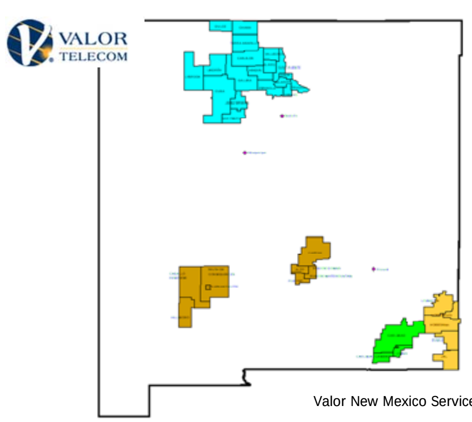
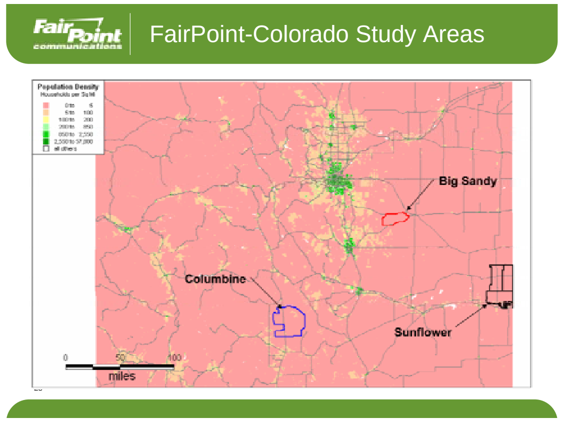


V. THE RURAL DEFINITION SHOULD NOT BE MODIFIED.

A. Multi-part "rural" definition reflects diversity of rural areas and the companies that serve them.
B. Sec. 254 focuses on "regions," and "rural, insular and high cost areas." These are the companies that serve them.
C. Study areas should not be combined.
   1. Support would be made less explicit.
   2. Unlike BOCs, rural companies have few urban areas to "average out" support.
   3. Holding company territories have small number of lines, low density, and are generally dispersed from one another.
   4. Efficiencies from holding company structure are already captured, as support is based on actual, embedded cost.
   5. Don't do anything to harm investment – this is the part of universal service that is working best!
D. Consistent with Qwest II (10th Circuit, 2-05) failed and unlawful policies of "non-rural" (large company) program should not be imposed on rural carriers.



Valor New Mexico Service Territories



VI. SUPPORT SHOULD BE BASED ON A COMPANY'S OWN COSTS.

A. It is costly, inefficient and anti-competitive to give CETCs support based on another company's documented costs.
B. CETCs, especially wireless, have different cost drivers, service obligations, and cost structures.
C. "Actual cost" coupled with rigorous ETC certification will meaningfully discipline fund growth and enhance program integrity.
D. Conditions identified by the Rural Task Force in 2000 when it recommended embedded costs have not changed.
E. The Rural Task Force concluded the embedded cost method was consistent with "no barriers to deployment" of advanced services.
    1. "Inherently provides incentives" for infrastructure investment.
    2. Must be "sufficient" and "predictable."
F. The FCC's Hybrid Cost Proxy Model has not been maintained, and its flaws have not been corrected.
G. Could create a forward-looking option for price cap rural carriers, such as Iowa Telecom, that do not receive sufficient support to rehabilitate acquired under-invested territory.
H. Policy makers must finally clarify that the High Cost Fund's **primary purpose** is to support **high-quality networks** over which multiple services can be deployed, not subsidize competition.

VII. SPECIFIC PROBLEMS, INCLUDING THE FUND CAP AND PARENT TRAP SHOULD BE ADDRESSED.

A. The high cost **loop fund cap** reduces recoverable cost. The shortfall between capped support and uncapped is now $465 million.
B. Creators of the high cost loop **growth factor** (rural line growth + inflation) did not envision negative line growth, which increases the shortfall between support and actual costs.
    1. Because networks are high fixed costs, line losses do not cause an equivalent reduction in costs. Variable costs (fuel, insurance) are actually increasing.
    2. "Something's gotta give": Investment, service, or customer rates.
C. **Investment in distressed property** should be supported.

1. Section 54.305 rules con concerning transferred exchanges limit ability to invest in acquired property, despite recent modification.
2. More can be done, even within the 5% of High Cost Loop cap (app. $53 million)
3. Section 54.305 discourages good transactions – getting property into the hands of companies that want to serve them.
4. Provide support based on acquirer's actual investment, support a higher percentage of investment, not just loop.

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Cap-related shortfall increasing year-to-year

Year	Capped	Uncapped	Difference
2005	$1,056,300,000	$1,521,579,759	($465,279,759)
2004	$1,056,800,000	$1,360,092,402	($303,292,402)
2003	$1,044,600,000	$1,243,201,380	($198,601,380)

$240 cap; based on annual FCC filings

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Rural Growth Factor (RGF)

		Percentage Change	
Year	RGF	Loop	GDP-CPI
2002	5.53	3.26	2.27
2003	2.27	-0.1	2.37
2004	2.66	1.53	1.13
2005 ytd	-0.04	-1.87	1.83

Source: NECA

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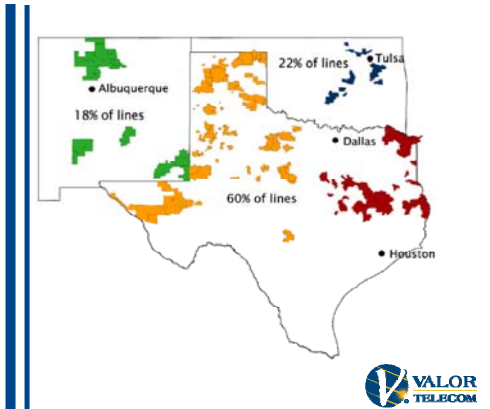
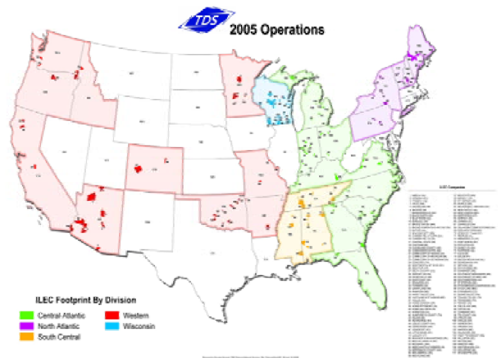
VIII. CONCLUSIONS.

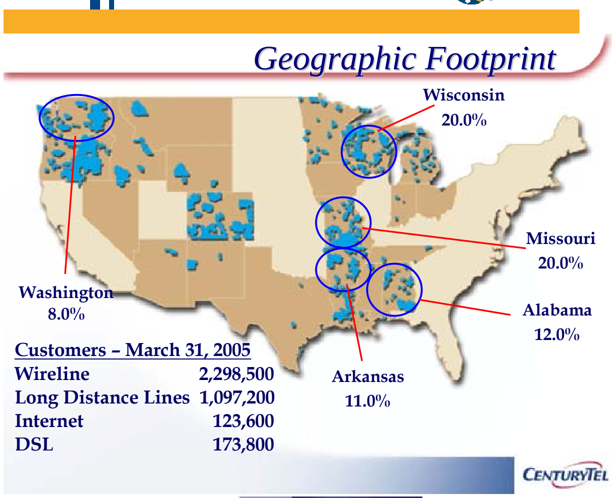
A. Effective reform must be **economically sound** and **politically feasible**.
B. Mid-size carriers provide **high quality basic service**, access to **advanced service**, and **Carrier of Last Resort**.
C. USF support increases to rural carriers have largely been revenue neutral access replacement – **"old money."**
D. USF support to CETCs, especially wireless, is **"new money,"** and is the primary driver of **fund growth**.
E. The **rural definition** should not be modified.
F. Eligibility and support should continue to be based on **study areas**.
G. Support should be based on the ETC's or CETC's **own costs**.
H. **Embedded** costs should continue to be used for most carriers.
I. Rigorous **certification** and review is in the interest of all ETCs and CETCs over the long-run, and ensures that customers receive value for support provided.
J. Policy makers must finally clarify that the High Cost Fund's **primary purpose** is to support **high-quality networks** over which multiple services can be deployed, not subsidize competition.



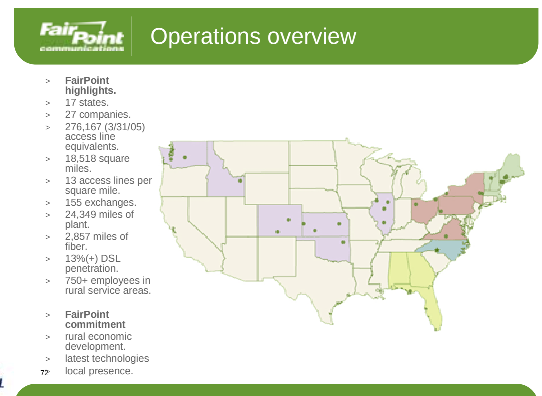
22% of lines
Tulsa
Albuquerque
18% of lines
Dallas
60% of lines
Houston
VALOR TELECOM



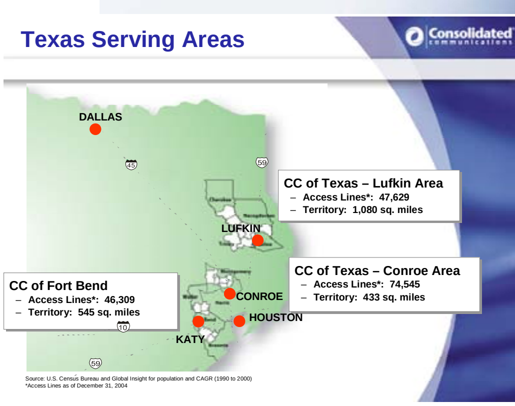
TDS 2005 Operations
ILEC Footprint By Division
Central Atlantic
North Atlantic
South Central
Western
Wisconsin



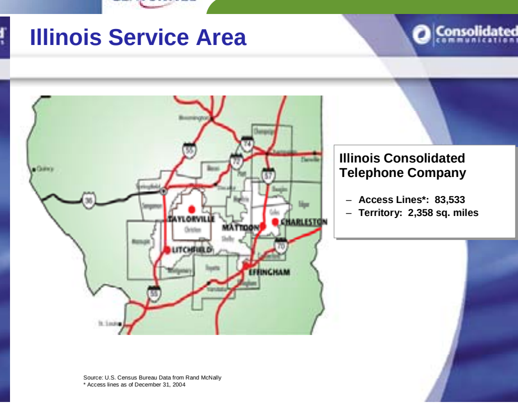
Geographic Footprint
Wisconsin 20.0%
Missouri 20.0%
Washington 8.0%
Alabama 12.0%
Arkansas 11.0%
Customers – March 31, 2005
Wireline 2,298,500
Long Distance Lines 1,097,200
Internet 123,600
DSL 173,800
CENTURYTEL



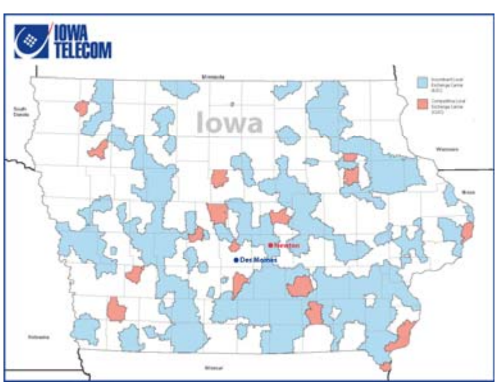
FairPoint communications
Operations overview
FairPoint highlights.
17 states.
27 companies.
276,167 (3/31/05) access line equivalents.
18,518 square miles.
13 access lines per square mile.
155 exchanges.
24,349 miles of plant.
2,857 miles of fiber.
13%(+) DSL penetration.
750+ employees in rural service areas.
FairPoint commitment
rural economic development.
latest technologies
local presence.



Texas Serving Areas
Consolidated communications
DALLAS
CC of Texas – Lufkin Area
– Access Lines*: 47,629
– Territory: 1,080 sq. miles
LUFKIN
CC of Texas – Conroe Area
– Access Lines*: 74,545
– Territory: 433 sq. miles
CC of Fort Bend
– Access Lines*: 46,309
– Territory: 545 sq. miles
CONROE
HOUSTON
KATY
Source: U.S. Census Bureau and Global Insight for population and CAGR (1990 to 2000)
*Access Lines as of December 31, 2004



Illinois Service Area
Consolidated communications
Illinois Consolidated Telephone Company
– Access Lines*: 83,533
– Territory: 2,358 sq. miles
TAYLORVILLE
MATTOON
CHARLESTON
LITCHFIELD
EFFINGHAM
Source: U.S. Census Bureau Data from Rand McNally
* Access lines as of December 31, 2004



IOWA TELECOM
Iowa
Des Moines